

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**AUDIT OF MEDICARE
TERMINATION COSTS CLAIMED BY
BLUE SHIELD OF CALIFORNIA FOR
THE PERIOD DECEMBER 1, 1996
THROUGH NOVEMBER 30, 1997**



JUNE GIBBS BROWN
Inspector General

DECEMBER 1999
A-09-99-00083

Department of Health and Human Services

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COSTS CLAIMED FOR THE PERIOD
DECEMBER 1, 1996 THROUGH
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The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represents the findings and opinions of the HHS/OIG Office of Audit Services. Final determination on these matters will be made by authorized officials.



JUNE GIBBS BROWN
Inspector General

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A-09-99-00083



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Region IX
Office of Audit Services
50 United Nations Plaza
San Francisco, CA 94102

CIN: A-09-99-00083
December 14, 1999

Karen Schievelbein
Senior Vice President and Chief Financial Officer
Blue Shield of California
50 Beale Street
San Francisco, California 94105

Dear Ms. Schievelbein:

Enclosed is the report covering the audit of termination costs incurred under the Medicare program by Blue Shield of California, for the period December 1, 1996 through November 30, 1997.

Your attention is invited to the audit findings and recommendations on pages 1 through 4 of the report, which are summarized in Exhibit A to our report. The below named Health Care Financing Administration (HCFA) official will be communicating with you in the near future regarding implementation of recommendations. Should you have any questions or comments concerning these recommendations, please submit them to HCFA no later than 30 days from the date of this letter. If no comments are received by this date, HCFA will proceed with the initiation of the closing agreement. Your comments should be sent to:

Regional Administrator
Health Care Financing Administration
75 Hawthorn Street, 4th Floor
San Francisco, California 94105

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To facilitate identification, please refer to Common Identification Number A-09-99-00083 in all correspondence relating to this report.

Sincerely,

A handwritten signature in black ink, appearing to read "Lawrence Frelot". The signature is fluid and cursive, with the first name "Lawrence" written in a larger, more prominent script than the last name "Frelot".

Lawrence Frelot
Regional Inspector General
for Audit Services

Enclosures

EXECUTIVE SUMMARY

During the period December 1, 1996 through November 30, 1997, California Physicians' Service, dba Blue Shield of California (BSC) claimed termination costs totaling \$2,813,246. The termination costs charged to Medicare were overstated by \$574,615. The overstatement consisted of improperly allocated severance costs, unallowable reconfiguration costs, unapproved professional fees, and unallowable outplacement services costs. We are recommending that BSC reduce its Medicare claim for the \$574,615 in overstated costs.

We also set aside reconfiguration costs of \$85,148 for the Health Care Financing Administration's (HCFA) determination because BSC was unable to provide the needed documentation to support that these costs were Medicare related.

BSC did not concur with our audit findings. Its response is included in its entirety as Appendix A.

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INTRODUCTION

BACKGROUND

The Medicare program is a Federal health insurance program whose beneficiaries include persons 65 years of age or over, disabled or blind persons, or those suffering from chronic renal disorders. Medicare was established by Congress in 1965 through the enactment of Title XVIII of the Social Security Act. Medicare consists of two distinct parts. Hospital Insurance (Part A) covers expenses of medical services furnished in an institutional setting, such as a hospital or skilled nursing facility, or provided by a home health agency. Supplemental Medical Insurance (Part B) covers physician services, certain other Medical equipment and services, and other outpatient services.

The Medicare program is administered by HCFA which contracted with BSC to receive, review, audit, and pay Medicare Part B claims. The BSC is entitled to reimbursement for the allowable administrative costs incurred, up to the contract ceiling, in carrying out its responsibilities under the program.

The BSC did not renew its Medicare Part B contract which expired September 30, 1996. The HCFA provided BSC a 2-month period to transfer its operations to the successor contractor.

The HCFA agreed to reimburse BSC for reasonable and allocable termination costs incurred in transferring responsibilities to the new contractor in accordance with Federal regulations. Our audit of the \$2,813,246 in termination costs claimed was made at the request of HCFA.

SCOPE OF AUDIT

Our audit was conducted in accordance with generally accepted government auditing standards. The primary purpose of the audit was to determine whether termination costs were allowable in accordance with the Medicare contract, applicable rules and regulations, and/or prior agreement with HCFA, and were supported by verifiable documentation.

We performed such tests of the accounting records and other auditing procedures as were considered necessary to meet our objective. In addition, we reviewed the personnel files for selected BSC terminated employees as deemed necessary.

The audit field work was conducted at BSC's San Francisco, California office during the period May 1999 through September 1999.

RESULTS OF AUDIT

The termination costs charged to Medicare were overstated by \$574,615. The \$574,615 consisted of improperly allocated severance costs of \$225,170, unallowable reconfiguration costs of \$165,312, unapproved professional fees of \$150,965, and unallowable outplacement services costs of \$33,168. We are recommending that BSC reduce its Medicare claim for the \$574,615 in

overstated costs.

We also set aside reconfiguration costs of \$85,148 for HCFA determination because BSC was unable to provide the needed documentation to support that these costs were Medicare related. The results of our audit are presented below and summarized in EXHIBIT A.

Severance Pay

We determined that \$1,077,363 of the \$1,302,533 claimed as severance was adequately supported as to allocability, allowability and reasonableness. However, the remaining \$225,170 is questioned as unallowable for Medicare reimbursement.

The BSC claimed Medicare reimbursement for severance costs for some employees who had previously worked in BSC's private lines of business. This resulted in an inequitable allocation of costs to the Medicare program because the private line of business did not pick up its fair share. In a letter dated January 31, 1997, HCFA told BSC that "HCFA will only reimburse severance pay for the portion of the employee's time spent with Medicare...." For a BSC employee with service time documented in both the Medicare department and other lines of business within BSC, the severance pay should be allocated to Medicare in proportion to the time worked on the Medicare program. As provided in 48 CFR 31.201-4(b), a cost is allocable to a government contract if it benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received.

Recommendation

We recommend that BSC exclude \$225,170 from the claim for termination costs.

Auditee Response

"Blue Shield continues to support the position that HCFA should reimburse 100 percent of the severance costs for all employees who were working in Medicare functions at the time of termination. It is a common business practice to charge the employee's full severance cost to the line of business last worked. While Blue Shield acknowledges that a few individuals receiving severance had worked in standard business earlier in their careers, that prior service was irrelevant to the termination event that triggered the severance payment."

Auditor's Comment

We continue to believe that severance costs should be allocated to Medicare in proportion to the time worked on the Medicare program.

Reconfiguration

We determined that \$7,614 of the \$258,074 claimed as reconfiguration was adequately supported as to allocability, allowability and reasonableness. The BSC claimed unallowable

reconfiguration costs of \$165,312 for the recreation of the standard business infrastructure. We have set aside the remaining \$85,148 for HCFA's determination because it includes non-medicare costs.

The HCFA requested that the space occupied by BSC and National Heritage Insurance Company (NHIC) in the Chico facility be physically separated. As a result, a wall was constructed to separate the two companies. In addition to the wall, BSC reconfigured its standard business space and adjusted its security and communications system.

In a letter dated January 31, 1997, HCFA told BSC that it would pay for the wall, but not the costs to reconfigure the BSC side:

"Inasmuch as it was a Blue Shield business decision to retain standard business employees in the Chico facility, HCFA is not responsible for and will not pay for Blue Shield's share of the demise expenses nor the costs associated with the recreation of the Standard Business infrastructure. Our position to not reimburse the cost of recreating the Standard Business environment is supported by FAR 31.205-31 which states, 'Plant conversion costs are those incurred in restoring or rehabilitating the contractor's facilities to approximately the same condition existing immediately before the start of the Government contract, fair wear and tear excepted. Reconversion costs are unallowable except for the cost of removing Government property and the restoration or rehabilitation costs caused by such removal.'"

We identified \$165,312 which was related to the recreation of the standard business infrastructure. Also, the building contractor did not separately identify the costs of the wall and the other changes to the BSC side of the wall. Therefore, we could not identify the costs for the construction of the wall and we have set aside costs of \$85,148.

Recommendation

We recommend that BSC exclude \$165,312 from the claim for termination costs. We set aside costs of \$85,148 for HCFA's determination.

Auditee Response

"During the transition period, Blue Shield worked in good faith to develop a facilities solution for the Chico operation that was acceptable to both HCFA and NHIC. Due to the lack of suitable space in the geographic area, as well as HCFA's goals of retaining existing staff and achieving a timely implementation, Blue Shield agreed to share its Chico facility with NHIC. NHIC did not want nor need the entire facility. If Blue Shield had not made 'a business decision to retain standard business employees in the Chico facility' as HCFA argues, NHIC would have either had to bear the full occupancy costs of the building or directly finance the reconfiguration costs required to house another tenant. In either case, the cost would have been borne by HCFA under the reimbursement contract. HCFA required the construction of the demising wall, and the space

reconfiguration and adjustment of security and communications systems on both sides of the wall resulted.”

Auditor’s Comment

Per FAR 31.205-31, reconversion costs are unallowable.

Professional Fees

We determined that \$91,708 of the \$242,673 claimed as professional fees was adequately supported as to allocability, allowability and reasonableness. However, the remaining \$150,965 is questioned as unallowable for Medicare reimbursement.

The BSC claimed professional fees which included the costs for an accounting firm to provide technical expertise relating to the preparation of the termination claim (\$128,896) and the costs of legal counsel to explain 401K transfer issues for employees who transistioned to the new contractor (\$22,069). The BSC did not request HCFA’s prior approval for these costs.

Section II, Part 1, Paragraph B of the Medicare contract states that:

“the prior written approval of the Contracting Officer shall be required...for the utilization of the services of any consultant under this contract where such reimbursement exceeds or may or may exceed \$400 per day or \$100,000 per year, exclusive of travel costs. Whenever Contracting Officer approval is required, the Contractor will obtain and furnish to the Contracting Officer information concerning the need for such consultant services and the reasonableness of the fees to be paid.”

The BSC did not comply with the contract requirements.

Recommendation

We recommend that BSC exclude \$150,965 from the claim for termination costs.

Auditee Response

“Our position on this issue is unchanged. Blue Shield did not have in-house staff available to perform the termination accounting functions. Arthur Anderson provided the expertise and staffing needed to complete the termination budget within HCFA’s timeframes. Legal services provided by Latham and Watkins directly benefited the Medicare employees that transistioned to NHIC. These employees had requested that their 401K plans transfer to the new employer, a matter that required legal review. Blue Shield typically contracts out for legal services such as this one where specific expertise is required.”

Auditor's Comment

The Medicare contract requires the prior written approval of the Contracting Officer for consultants.

Outplacement Services

The BSC claimed outplacement services of \$33,168 which are unallowable. The contractor provided individual and group counseling for severed employees. In a letter dated January 31, 1997, HCFA told BSC that it would not pay these costs:

“HCFA will not pay for the cost of outplacement services. Outplacement programs included in company severance policies are considered discretionary. We believe HCFA is obligated to reimburse severance pay based upon an employee's years of Medicare service. However, HCFA is under no obligation to reimburse Blue Shield for costs associated with helping severed employees enhance their prospect for future employment.”

Recommendation

We recommend that BSC exclude \$33,168 from the claim for termination costs.

Auditee Response

“We continue to strongly believe that the outplacement services provided to the terminated employees were reasonable and allowable under FAR 31.205-33(b) Professional and consultant service costs. Outplacement assistance is a standard part of Blue Shield's severance policy. In the case of the Medicare termination, this assistance was especially critical. Many of the employees had worked for the Medicare Program for their entire careers, in addition to the fact that Chico and Marysville are rural locations with limited employment opportunities. Resume writing and job search counseling was essential in facilitating a smooth transistion for HCFA.”

Auditor's Comment

We continue to believe that these outplacement services costs are not related to Medicare.

RECOMMENDATIONS

We recommend that the Medicare claim for termination costs be reduced by \$574,615 and we set aside costs of \$85,148 for HCFA's determination.

CALIFORNIA PHYSICIANS' SERVICES, SAN FRANCISCO
DBA BLUE SHIELD OF CALIFORNIA
SUMMARY OF RESULTS OF AUDIT
OF MEDICARE TERMINATION COSTS
FOR THE PERIOD
DECEMBER 1, 1996 THROUGH NOVEMBER 30, 1997

	<u>Total</u> <u>Proposed</u>	<u>Recommended</u> <u>Adjustments</u>	<u>Costs</u> <u>Set Aside</u>
Severance Pay	\$1,302,533	\$225,170	
Separation Payroll Tax	106,995		
Health Insurance	81,514		
Continuing Costs	37,221		
Fixed Assets	719,666		
Storage of Files	1,118		
Reconfiguration	258,074	165,312	\$85,148
Professional Fees	242,673	150,965	
Outplacement Services	33,168	33,168	
Check and EOMB Stock	15,375		
Severance Run-Off	<u>14,909</u>	<u> </u>	<u> </u>
Total	<u>\$2,813,246</u>	<u>\$574,615</u>	<u>\$85,148</u>

APPENDIX A
AUDITEE'S RESPONSE

December 6, 1999

Ms. Alysson Blake
Associate Regional Administrator
Division of Medicare
Health Care Financing Administration
75 Hawthorne Street, 5th Floor
San Francisco, CA 94105

Re: CIN A-09-99-00083

Dear Ms. Blake:

We have reviewed the Office of Inspector General's draft audit report entitled "Audit of Medicare Termination Costs Claimed for the period December 1, 1996 through November 30, 1997. We believe that our December 5, 1996 Termination Budget Request and our July 10, 1997 letter adequately express our opinions and related to the findings and recommendations contained in the report. We summarize our positions below, however, please refer to our July 10, 1997 letter (attached) and our initial termination budget submission dated December 5, 1996 for full discussion.

Severance Pay

Blue Shield continues to support the position that HCFA should reimburse 100 percent of the severance costs for all employees who were working in Medicare functions at the time of termination. It is a common business practice to charge the employee's full severance cost to the line of business last worked. While Blue Shield acknowledges that a few individuals receiving severance had worked in standard business earlier in their careers, that prior service was irrelevant to the termination event that triggered the severance payment.

Reconfiguration

During the transition period, Blue Shield worked in good faith to develop a facilities solution for the Chico operation that was acceptable to both HCFA and NHIC. Due to the lack of suitable space in the geographic area, as well as HCFA's goals of retaining existing staff and achieving a timely implementation, Blue Shield agreed to share its Chico facility with NHIC. NHIC did not want nor need the entire facility. If Blue Shield had not made "a business decision to retain standard business employees in the Chico facility" as HCFA argues, NHIC would have either had to bear the full occupancy costs of the building or directly finance the reconfiguration costs required to house another tenant. In either case, the cost would have been borne by HCFA under the reimbursement contract. HCFA required the construction of the demising wall, and the space reconfiguration and adjustment of security and communications systems on both sides of the wall resulted.

Professional Fees

Our position on this issue is unchanged. Blue Shield did not have in-house staff available to perform the termination accounting functions. Arthur Andersen provided the expertise and staffing needed to complete the termination budget within HCFA's timeframes. Legal services provided by Latham and Watkins directly benefited the Medicare employees that transitioned to NHIC. These employees had requested that their 401K plans transfer to the new employer, a matter that required legal review. Blue Shield typically contracts out for legal services such as this one where specific expertise is required.

Outplacement Services

We continue to strongly believe that the outplacement services provided to the terminated employees were reasonable and allowable under FAR 31.205-33(b) Professional and consultant service costs. Outplacement assistance is a standard part of Blue Shield's severance policy. In the case of the Medicare termination, this assistance was especially critical. Many of the employees had worked for the Medicare Program for their entire careers, in addition to the fact that Chico and Marysville are rural locations with limited employment opportunities. Resume writing and job search counseling was essential in facilitating a smooth transition for HCFA.

We look forward to working with you and your staff to finalize an agreement on these issues. If you have any questions, please contact me directly at (415) 229-5057.

Sincerely,



Karen Schievelbein
Senior Vice President and
Chief Financial Officer

Attachments